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Checklist supplement and illustrative financial statements for construction contractors : a financial accounting and reporting practice aid, January 1999 edition

American Institute of Certified Public Accountants. Accounting and Auditing Publications

George Dietz

AICPA

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Checklist Supplement and Illustrative Financial Statements for Construction Contractors

A Financial Accounting and Reporting Practice Aid

To be used in conjunction with Checklists and Illustrative Financial Statements for Corporations

Edited by

George Dietz, CPA

Senior Manager, Accounting and Auditing Publications

Checklist Supplement and Illustrative Financial Statements for Construction Contractors has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board and has no official or authoritative status.

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FSP Section 5000

Checklist Supplement and Illustrative Financial Statements for Construction Contractors

.01 The checklist and illustrative financial statements included in this section are not designed to be applied to the financial statements of government contractors.

.02 The checklist and illustrative financial statements have been developed by the AICPA Accounting and Auditing Publications Team as nonauthoritative technical practice aids. Readers should be aware of the following:

- The checklist and illustrative financial statements are "tools" and in no way represent official positions or pronouncements of the AICPA.
- The checklist and illustrative financial statements are to be used in conjunction with the "Checklists and Illustrative Financial Statements for Corporations" (FSP sections 6000–6500) and have been updated to include relevant accounting pronouncements through FASB Statement of Financial Accounting Standards No. 134, FASB Interpretation No. 42, FASB Technical Bulletin No. 97-1, AICPA Statement of Position No. 98-9, AICPA Practice Bulletin No. 15, AICPA Audit and Accounting Guide *Construction Contractors* (with conforming changes as of May 1, 1998), and FASB Emerging Issues Task Force consensuses reached through September 1998. The checklist and illustrative financial statements should be modified, as appropriate, for subsequent pronouncements. In determining the applicability of a pronouncement, its effective date should also be considered.
- The checklist and illustrative financial statements should be used by, or under the supervision of, persons having adequate technical training and proficiency in the application of generally accepted accounting principles, generally accepted auditing standards, and statements on standards for accounting and review services.
- The checklist and illustrative financial statements do not include all disclosures and presentation items promulgated. The referenced standards should be reviewed if clarification is needed to determine whether the disclosure indicated is required or suggested, and to what extent each disclosure is relevant to the statements being presented.

.03 Users of the checklist and illustrative financial statements are urged to refer directly to applicable authoritative pronouncements when appropriate. If you have further questions, call the AICPA Technical Hotline at (888) 777-7077 (AICPA members only).

Note: This publication was extracted from sections 5000 through 5300 of the AICPA *Financial Statement Preparation Manual* (FSP).

FSP Section 5100
Introduction

.01 The range of size and sophistication of companies in the construction industry has produced a variety of construction-type contracts and types of business enterprises that use them.

.02 The organizational structure, resources, and capabilities of contractors tend to vary with the type of construction activity.

.03 Common accounting and reporting practices by contractors include:

- The predominant practice is to present balance sheets with assets and liabilities classified as current and noncurrent on the basis of one year or the operating cycle. An unclassified balance sheet is also acceptable.
- Costs and estimated earnings in excess of billings are classified as current assets, and billings in excess of costs and estimated earnings are classified as current liabilities.
- Net debit balances for certain contracts should not be offset against net credit balances of other unrelated contracts.
- Contractors frequently participate in joint ventures, corporations, and general or limited partnerships. These may be reported as investments or combined or consolidated in the financial statements.
- The percentage-of-completion method of contract accounting is preferable, but the completed-contract method is also acceptable in certain circumstances.
- The method of revenue recognition should be disclosed.
- A provision for losses on a contract should be made as soon as the losses become evident, regardless of the method of accounting for the contract, and reported as a liability or deducted from any related accumulated costs.
- Contractors are encouraged to present backlog information.

FSP Section 5200
Financial Statements and Notes Checklist

.01 This checklist has been developed by the staff of the Accounting and Auditing Publications Team of the AICPA as a nonauthoritative practice aid and is to be used in conjunction with the "Checklists and Illustrative Financial Statements for Corporations" (FSP sections 6000–6500). This checklist has been developed especially for use in audits of construction contractors. Included are only those required financial statement disclosures that are likely to be unique, or especially significant, to construction contractors. Accordingly, users should carefully consider the need to modify the checklist for any additional disclosure requirements and/or reporting situations encountered during the engagement.

.02 For each item, place a check mark in the "Yes," "No," or "N/A" (not applicable) column. Add additional explanations such as "N/M" (not material) if necessary.

.03 Explanation of References:

AAG =	Reference to section number or appendix in AICPA Audit and Accounting Guide *Construction Contractors* (with conforming changes as of May 1, 1998)
AC =	Reference to section number in FASB *Accounting Standards—Current Text*
APB =	AICPA Accounting Principles Board Opinion
ARB =	AICPA Accounting Research Bulletin
SFAS =	FASB Statement of Financial Accounting Standards
SOP =	AICPA Statement of Position

.04 Checklist Questionnaire:

	Yes	*No*	*N/A*
General			
A. Accounting Policies			
1. Is the method of reporting affiliates disclosed relative to:			
a. The consolidation policy when consolidated statements are presented? [ARB 51, par. 5 (AC C51.108)]	____	____	____
b. Investments in joint ventures? [AAG, par. 6.21; APB 18, par. 20 (AC I82.110)]	____	____	____
c. Other affiliates? [AAG, par. 6.21; APB 18, par. 20 (AC I82.110)]	____	____	____
2. If the operating cycle exceeds one year, is the range of contract durations disclosed? [AAG, par. 6.21]	____	____	____
3. Income recognition:			
a. Is the method of recognizing income (percentage-of-completion or completed-contract) disclosed? [AAG, par. 6.21; SOP 81-1 (AAG, App. A), par. 21]	____	____	____

	Yes	No	N/A
b. If the percentage-of-completion method is used, is the method of computing percentage of completion (such as cost-to-cost, labor hours, units of output, etc.) disclosed? [AAG, par. 6.21; SOP 81-1 (AAG, App. A), par. 45]	____	____	____
c. If the completed-contract method is used:			
(1) Is the reason for selecting that method disclosed? [AAG, par. 6.21]	____	____	____
(2) Are the criteria which were employed to determine substantial completion, disclosed? [SOP 81-1 (AAG, App. A), par. 52]	____	____	____
d. Where applicable, is the policy with respect to combining or segmenting contracts disclosed? [SOP 81-1 (AAG, App. A), par. 21]	____	____	____
e. If the basic accounting policy is percentage-of-completion, but the completed-contract method is used for a single contract or group of contracts because the criteria for the use of percentage-of-completion are not present, is such a departure from the basic policy disclosed? [AAG, par. 2.06; SOP 81-1 (AAG, App. A), par. 25]	____	____	____
4. Is the following contract cost information disclosed:			
a. The aggregate amount included in contract costs representing unapproved change orders, claims, or similar items subject to uncertainty concerning their determination or ultimate realization, in addition to a description of the nature and status of the principal items making up such aggregate amounts, and the basis on which such items are recorded (e.g., cost or realizable value)? [AAG, par. 6.21; SOP 81-1 (AAG, App. A), par. 65]	____	____	____
b. The amount of progress payments netted against contract costs at the date of the balance sheet? [AAG, par. 6.21]	____	____	____
5. If a loss on a contract is disclosed, is the:			
a. Provision in the income statement included in contract cost (as opposed to a reduction in revenue) or shown separately as a component of the cost included in the computation of gross profit? [SOP 81-1 (AAG, App. A), par. 88]	____	____	____
b. Allowance in the balance sheet shown separately as either a liability (a current liability if a classified balance sheet) or deduction from the related accumulated costs? [SOP 81-1 (AAG, App. A), par. 89]	____	____	____
6. For costs deferred either in anticipation of future sales (pre-contract costs*) or as a result of an unapproved change order, are the policy of deferral and the amounts involved disclosed? [AAG, par. 6.21]	____	____	____

* SOP 98-5, *Reporting on the Costs of Start-Up Activities*, which is effective for financial statements for fiscal years beginning after December 15, 1998, requires precontract costs that are start-up costs to be expensed as incurred.

	Yes	No	N/A

B. Accounting Changes

1. For special changes requiring restatement, such as a change in method of accounting for long-term construction contracts, are the following disclosed:

   a. Nature of the change? ___ ___ ___

   b. Justification for the change? ___ ___ ___

   c. Effect on income before extraordinary items and net income (and related earnings-per-share amounts, if applicable) in the period of the change for all periods presented? ___ ___ ___
   [APB 20, pars. 27–28 (AC A06.123–.124 and A35.114–.115)]

2. Have changes in accounting estimates such as revisions in cost and profit estimates or in estimates of the percentage of completion been disclosed? ___ ___ ___
   [AAG, par. 2.19; APB 20, par. 33 (AC A06.132)]

C. Related-Party Transactions and Economic Dependency

1. If it appears that there are affiliated members of a group under common control whose operations are closely interrelated and economically interdependent, are combined financial statements presented, unless consolidated financial statements are appropriate under ARB 51 and SFAS 94 (AC C51)? ___ ___ ___
   [AAG, par. 4.03]

2. If combined financial statements are presented, is the following information disclosed:

   a. A statement to the effect that the statements are not those of a separate legal entity? ___ ___ ___

   b. The names and year ends of the major entities included in the combined group? ___ ___ ___

   c. The nature of the relationship between the companies? ___ ___ ___

   d. The capital of each entity, either in detail by entity if the number of entities is small or, if detailed disclosure is not practicable, in condensed form with an explanation as to how the information was accumulated? ___ ___ ___
   [AAG, par. 4.04]

3. Although consolidated or combined statements of affiliated companies are recommended as the primary financial statements of an economic unit, the needs of specific users may sometimes necessitate the presentation of separate statements for individual members of an affiliated group. The issuer of separate financial statements for a member of an affiliated group should make appropriate disclosures on related parties. In accordance with SFAS 57, do the financial statements of the reporting entity that has participated in material related party transactions disclose, individually or in the aggregate, the following:

   a. The nature of the relationship(s) involved? (The nature of common control should be disclosed even when no transactions between the parties have occurred.) ___ ___ ___

	Yes	No	N/A
b. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements?	____	____	____
c. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period?	____	____	____
d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement?	____	____	____
e. The information required by paragraph 49 of SFAS 109, *Accounting for Income Taxes*? [SFAS 57, par. 2 (AC R36.102); AAG, par. 4.06]	____	____	____
f. In addition, as recommended by the guide, has presentation been made in a note to the financial statements of the condensed, consolidated or combined balance sheet and statement of income of the members of the affiliated group that constitute the economic unit? [AAG, par. 4.07]	____	____	____

D. Contingencies and Commitments*

	Yes	No	N/A
1. If backlog information is disclosed (by industry or type of facility and by location—domestic or foreign), are signed contracts on hand (whose cancellations are not anticipated) disclosed separately from backlog on letters of intent?	____	____	____
2. Has consideration been given to disclosing backlog at the beginning of the year, new contract awards, revenue recognized for the year, and backlog at the end of the year, in the form of a schedule? [AAG, par. 6.23]	____	____	____
3. Are disclosure requirements of state statutes (such as "lien" laws restricting certain contract-related funds) considered? [AAG, par. 11.14]	____	____	____
4. If material, are the amounts of claims revenue recognized disclosed in the notes to the financial statements? [SOP 81-1 (AAG, App. A), par. 65]	____	____	____
5. If the reporting entity has retail land sales operations, are the following disclosed regarding improvements:			
a. For major sales areas for each of the next five years:			
(1) Estimated total costs?	____	____	____
(2) Estimated expenditures?	____	____	____

* See disclosures for SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, in the Corporate Checklist, FSP section 6000. Construction contractors frequently encounter events that give rise to the disclosure that it is at least reasonably possible that a change in estimate will occur in the near term due to the large number of estimates inherent in construction contractor financial statements. In addition, contractors also experience vulnerabilities due to certain concentrations by having a single source of supplier or only employing union labor.

	Yes	No	N/A
b. Recorded obligations? [SFAS 66, par. 50 (AC Rel. 150)]	____	____	____

E. Interest Costs

1. If interest costs are capitalized for long-term construction contracts, is the total interest incurred and capitalized disclosed for each period presented? [SFAS 34, par. 21 (AC I67.118)]	____	____	____

Balance Sheet

A. General

1. If a company has an operating cycle for most of its contracts of one year or less but periodically obtains some contracts that are significantly longer and a classified balance sheet is presented, is there:

a. A separate classification for the items that relate to contracts that deviate from the company's normal operating cycle?	____	____	____
b. Disclosure for the items that relate to contracts that deviate from the company's normal operating cycle? [AAG, par. 6.02]	____	____	____

2. If the operating cycle exceeds one year, an unclassified balance sheet is preferable; however, if an unclassified balance sheet would not result in a meaningful presentation, are the following contract-related items generally classified as current under the operating cycle concept:

a. Contract-related assets:

(1) Accounts receivable on contracts (including retentions)?	____	____	____
(2) Unbilled contract receivables?	____	____	____
(3) Costs and estimated earnings in excess of billings?	____	____	____
(4) Other deferred contract costs?	____	____	____
(5) Equipment and small tools specifically purchased for, or expected to be used solely on, an individual contract?	____	____	____

b. Contract-related liabilities:

(1) Accounts payable on contracts (including retentions)?	____	____	____
(2) Accrued contract costs?	____	____	____
(3) Billings in excess of costs and estimated earnings?	____	____	____
(4) Deferred taxes resulting from the use of a method of income recognition for tax purposes different from the method used for financial reporting purposes?	____	____	____
(5) Advance payments on contracts for mobilization or other purposes?	____	____	____
(6) Obligations for equipment specifically purchased for, or expected to be used solely on, an individual contract regardless of the payment terms of the obligations?	____	____	____

	Yes	No	N/A
(7) Provisions for losses on contracts (except in circumstances where the related costs are accumulated on the balance sheet, in which case the provision may be deducted from the related accumulated costs)? [AAG, pars. 6.01–.08; SOP 81-1 (AAG, App. A), par. 89]	____	____	____
3. If the company's operating cycle exceeds one year, or if it uses an unclassified balance sheet:			
a. Has the company disclosed liquidity characteristics of specific assets and liabilities if its operating cycle exceeds one year or if it has an unclassified balance sheet?	____	____	____
b. Has information about specific assets and liabilities including, but not limited to, accounts and retentions receivable and payable been disclosed? [AAG, par. 6.03]	____	____	____
B. Receivables			
1. Are the amount, nature, and status of billed or unbilled receivables representing unapproved change orders, claims, or similar items subject to uncertainty disclosed, including amounts expected to be collected after one year? [AAG, par. 6.24]	____	____	____
2. Are receivables representing the recognized sales value of performance under contracts that are neither billed nor billable to customers at the balance-sheet date disclosed with a general description of the prerequisite for billing?	____	____	____
a. Are the amounts to be collected after one year disclosed? [AAG, par. 6.25]	____	____	____
3. If revenue from claims is recorded only when the amounts are received or awarded, is the total of such claims disclosed? [SOP 81-1 (AAG, App. A), par. 66; SFAS 5, par. 17 (AC C59.118)]	____	____	____
4. If receivables include amounts maturing after one year, are the following disclosed:			
a. The amount maturing after one year and, if practicable, the amounts maturing in each year?	____	____	____
b. Interest rates on major receivable items, or on classes of receivables, maturing after one year or an indication of the average interest rate or the range of rates on all receivables? [AAG, par. 6.27]	____	____	____
5. If receivables include amounts representing balances billed but not yet paid by customers under retainage provisions, is disclosure made of the amounts included, the amounts expected to be collected after one year, and, if practicable, the years in which the amounts are expected to be collected? [AAG, pars. 6.03 and 6.28]	____	____	____
6. Are retentions receivable not due within the company's operating cycle classified as noncurrent in a classified balance sheet? [AAG, pars. 6.10 and 6.28]	____	____	____

	Yes	No	N/A
7. For receivable from retail land sales operations, are the following disclosed:			
a. Maturities for each of the next five years?	____	____	____
b. Delinquent amounts and methods of determination?	____	____	____
c. Weighted average and range of stated interest rates? [SFAS 66, par. 50 (AC Rel. 150)]	____	____	____
8. Are advances that are definitely regarded as payments on account of work in progress shown as a deduction from the related asset, and are the amounts disclosed? [AAG, par. 6.19]	____	____	____

C. Investments

	Yes	No	N/A
1. Have the following additional disclosures relating to significant joint ventures been considered by the venturer:			
a. The name of each joint venture, the percentage of ownership, and any important provisions of the joint venture agreement? [AAG, par. 3.27]	____	____	____
b. If the joint venture's financial statements are not fully consolidated with those of the venturer, separate or combined financial statements of the ventures in summary form, including disclosure of accounting principles of the ventures that differ significantly from those of the venturer? [AAG, par. 3.27]	____	____	____
c. Intercompany transactions during the period and the basis of intercompany billings and charges? [AAG, par. 3.27]	____	____	____
d. Liabilities and contingent liabilities arising from the joint venture arrangement? [AAG, par. 3.27]	____	____	____
e. Other disclosures for real estate venture and equity method investments? [SOP 78-9, par. 12; APB 18, par. 20 (AC I82.110)]	____	____	____
2. Is an investment in a joint venture that is presented on the cost or equity method classified as noncurrent unless the venture is expected to be completed and liquidated during the current operating cycle? [AAG, par. 6.11]	____	____	____
3. Are losses in excess of an investment in a joint venture presented as a liability? [AAG, par. 6.11]	____	____	____

D. Property and Equipment

	Yes	No	N/A
1. If it appears that equipment acquired for a specific contract will be used only on that contract and will be consumed during the life of the contract or disposed of at the conclusion of the contract, is such equipment classified as a contract cost? [AAG, par. 6.12]	____	____	____

	Yes	No	N/A

E. Current Liabilities

1. For billings, costs, and estimated earnings:

   a. If costs and estimated earnings exceed billings on some contracts, and billings exceed costs and estimated earnings on others, are the contracts segregated so that amounts classified as assets include only those on which costs and estimated earnings exceed billings, and amounts classified as liabilities include only those on which billings exceed costs and estimated earnings? [AAG, pars. 6.16–6.19; ARB 45, par. 12 (AC Co4.109)] ____ ____ ____

   b. Are billings and related costs and estimated earnings presented separately in the balance sheet or in the notes to the financial statements? [AAG, par. 6.18] ____ ____ ____

   c. Are billings in excess of costs and estimated earnings classified as a current liability (except that billings in excess of total estimated contract completion costs and earnings to date should be classified as deferred income)? [AAG, par. 6.13] ____ ____ ____

F. Other Liabilities and Deferred Credits

1. If payables include retentions, do the statements or notes disclose their amount, the portion (if any) expected to be paid after one year and, if practicable, the years in which the amounts are expected to be paid? [AAG, par. 6.03] ____ ____ ____

2. Are retentions payable, that do not appear due within the company's operating cycle, classified as noncurrent in a classified balance sheet? [AAG, par. 6.10] ____ ____ ____

3. Are the disclosures and classifications appropriate regarding the income tax effects of differences between financial and tax reporting of:

   a. Long-term construction contracts? ____ ____ ____

   b. Investments in joint ventures and partnerships? ____ ____ ____
   [AAG, par. 6.15; SFAS 109, pars. 41–43 (AC I27.142)]

G. Other

1. If a lessee commences construction activities prior to the involvement of a special purpose entity (SPE), and the subsequent transfer to the SPE is within the scope of SFAS 98, *Accounting for Leases*, and the transaction fails to qualify for sale-leaseback accounting under SFAS 98, SFAS 28, *Accounting for Sales with Leasebacks*, or SFAS 66, *Accounting for Sales of Real Estate*, are the amounts previously expended by the lessee continually reported as construction in progress in the lessee's financial statements and the proceeds received from the SPE reported as a liability? [EITF 96-21] ____ ____ ____

2. Are additional amounts expended by the SPE to fund construction reported by the lessee as construction in progress and as a liability to the SPE? [EITF 96-21] ____ ____ ____

	Yes	No	N/A

Accompanying Information

A. Supplemental Disclosures

1. Is disclosure of the following supplementary information considered by contractors using the percentage-of-completion method:

	Yes	No	N/A
a. Earnings from contracts?	____	____	____
b. Contracts completed?	____	____	____
c. Contracts in progress?	____	____	____
d. Backlog information? [AAG, App. G]	____	____	____

FSP Section 5300
Illustrative Financial Statements

.01 These checklists include disclosures commonly encountered in a construction contractor's financial statements; they **do not** include all disclosures required by GAAP. Further, the illustrative financial statements are intended to provide sample financial statement formats and disclosures for a hypothetical construction contractor; they are not intended to illustrate all disclosures required by GAAP, nor do they illustrate all of the disclosures covered in the checklist.

.02 The following illustrative auditor's reports and financial statements demonstrate the practical applications of the reporting practices discussed in the AICPA Audit and Accounting Guide *Construction Contractors* (the Guide). Some of the illustrations have been modified for subsequent pronouncements. Specific types of construction contractors have been selected to illustrate diversity of reporting practices; it is not intended that these illustrations represent either the only types of disclosure or the only statement formats that would be appropriate. Construction contractors are urged to develop financial statement formats that are appropriate for their individual circumstances while being consistent with the accounting and reporting practices discussed in the Guide.

.03

Independent Auditor's Report

To the Shareholders and Board of Directors
Percentage Contractors, Inc.

We have audited the accompanying consolidated balance sheets of Percentage Contractors, Inc. and subsidiaries as of December 31, 19X8 and 19X7, and the related consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Percentage Contractors, Inc. and subsidiaries as of December 31, 19X8 and 19X7, and the results of their operations and their cash flows for the years then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*City, State*]*

February 18, 19X9

* Optional if office location is on auditor's letterhead.

These illustrative financial statements are intended to provide sample financial statement formats and disclosures for a hypothetical construction contractor; they are not intended to illustrate all disclosures required by GAAP or all of the disclosures covered in the checklist.

.04

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 19X8 and 19X7

Assets	*19X8*	*19X7*
Cash and cash equivalents (including certificates of deposit of $40,300 in 19X8)	$ 304,400	$ 221,300
Contract receivables (Note 3)	3,789,200	3,334,100
Costs and estimated earnings in excess of billings on uncompleted contracts (Note 4)	80,200	100,600
Inventory, at lower of cost, on a first-in, first-out basis, or market	89,700	99,100
Prepaid charges and other assets	118,400	83,200
Advances to and equity in joint venture (Note 5)	205,600	130,700
Note receivable, related company (Note 6)	175,000	150,000
Property and equipment, net of accumulated depreciation and amortization (Note 7)	976,400	1,019,200
	$5,738,900	$5,138,200
Liabilities and Shareholders' Equity		
Notes payable (Note 9)	$ 468,100	$ 578,400
Lease obligations payable (Note 10)	197,600	251,300
Accounts payable (Note 8)	2,543,100	2,588,500
Billings in excess of costs and estimated earnings on uncompleted contracts (Note 4)	242,000	221,700
Other accrued liabilities	88,600	114,600
Due to consolidated joint venture minority interests	154,200	26,200
Deferred income taxes (Note 13)	619,200	408,000
	4,312,800	4,188,700
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Common stock—$1 par value, 500,000 authorized shares, 300,000 issued and outstanding shares	300,000	300,000
Retained earnings	1,126,100	649,500
Total shareholders' equity	1,426,100	949,500
	$5,738,900	$5,138,200

The accompanying notes are an integral part of these financial statements.

.05

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Consolidated Statements of Income* and Retained Earnings

Years Ended December 31, 19X8 and 19X7

	19X8	*19X7*
Contract revenues earned	$22,554,100	$16,225,400
Cost of revenues earned	20,359,400	14,951,300
Gross profit	2,194,700	1,274,100
Selling, general, and administrative expenses	895,600	755,600
Income from operations	1,299,100	518,500
Other income (expense)		
Equity in earnings from unconsolidated joint venture	49,900	5,700
Gain on sale of equipment	10,000	2,000
Interest expense (net of interest income of $8,800 in 19X8 and $6,300 in 19X7)	(69,500)	(70,800)
	(9,600)	(63,100)
Income before income taxes	1,289,500	455,400
Provision for income taxes (Note 13)	662,900	225,000
Net income	626,600	230,400
Basic and diluted earnings per share**	2.09	.77
Retained earnings, beginning of year	649,500	569,100
Less dividends paid (per share, $.50 (19X8); $.50 (19X7))	(150,000)	(150,000)
Retained earnings, end of year	$ 1,126,100	$ 649,500

The accompanying notes are an integral part of these financial statements.

* SFAS 130, *Reporting Comprehensive Income,* establishes standards for the reporting and display of comprehensive income and its components. The Statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Statement does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. The Statement does not apply to an enterprise that has no items of other comprehensive income in any period presented.

** SFAS 128, *Earnings Per Share,* requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. The Statement also requires presentation of earnings per share by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market.

.06

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Consolidated Statements of Cash Flows*

Years Ended December 31, 19X8 and 19X7

	19X8	*19X7*
Cash flows from operating activities:		
Net income	$626,600	$230,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	167,800	153,500
Gain on sale of equipment	(10,000)	(2,000)
Equity earnings from unconsolidated joint venture	(49,900)	(5,700)
Increase (decrease) in deferred income taxes	211,200	(75,900)
Increase in contract receivables	(461,400)	(10,200)
Provisions for losses on accounts receivable	6,300	1,100
Net increase in billings related to costs and estimated earnings on uncompleted contracts	40,700	10,500
Decrease (increase) in inventory	9,400	(3,600)
Decrease (increase) in prepaid charges and other assets	(35,200)	16,100
Increase (decrease) in accounts payable	(45,400)	113,200
Increase in other accrued liabilities	(26,000)	18,800
Net cash provided by operating activities	434,100	446,200
Cash flows from investing activities:		
Proceeds from equipment sold	25,000	5,000
Acquisition of equipment	(140,000)	(175,000)
Advances to joint venture	(25,000)	(9,700)
Increase in note receivable, related company	(25,000)	(50,000)
Net cash used in investing activities	(165,000)	(229,700)
Cash flows from financing activities:		
Principal payments on notes payable	(110,300)	(90,300)
Principal payments under capital lease obligation	(53,700)	(9,700)
Increase in joint venture minority interest	128,000	26,200
Cash dividends paid	(150,000)	(150,000)
Net cash used in financing activities	(186,000)	(223,800)
Net increase (decrease) in cash and cash equivalents	83,100	(7,300)
Cash, beginning of year	221,300	228,600
Cash and cash equivalents, end of year	$304,400	$221,300
Supplementary data:		
Cash equivalents include certificates of deposit with maturities of one to three months		
Interest paid	$ 73,500	$ 75,100
Income taxes paid	$478,300	$313,200

The accompanying notes are an integral part of these financial statements.

* The indirect method is illustrated.

.07

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

Years Ended December 31, 19X8 and 19X7

Note 1: Nature of Operations and Significant Accounting Policies

Nature of operations. The company is engaged in the construction of industrial and commercial buildings primarily in the Southwestern region of the United States.

Operating cycle. The company's work is performed under cost-plus-fee contracts, fixed-price contracts, and fixed-price contracts modified by incentive and penalty provisions. These contracts are undertaken by the company or its wholly owned subsidiary alone or in partnership with other contractors through joint ventures. The company also manages, for a fee, construction projects of others. The length of the company's contracts varies but is typically about two years. Therefore, assets and liabilities are not classified as current and noncurrent because the contract-related items in the balance sheet have realization and liquidation periods extending beyond one year.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Principles of consolidation. The consolidated financial statements include the company's majority-owned entities, a wholly owned corporate subsidiary and a 75 percent-owned joint venture (a partnership). All significant intercompany transactions are eliminated. The company has a minority interest in a joint venture (partnership), which is reported on the equity method.

Revenue and cost recognition. Revenues from fixed-price and modified fixed-price construction contracts are recognized on the percentage-of-completion method, measured by the percentage of labor hours incurred to date to estimated total labor hours for each contract.* This method is used because management considers expended labor hours to be the best available measure of progress on these contracts. Revenues from cost-plus-fee contracts are recognized on the basis of costs incurred during the period plus the fee earned, measured by the cost-to-cost method.

Contracts to manage, supervise, or coordinate the construction activity of others are recognized only to the extent of the fee revenue. The revenue earned in a period is based on the ratio of hours incurred to the total estimated hours required by the contract.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. Selling, general, and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined. Profit incentives are included in revenues when their realization is reasonably assured. An amount equal to contract costs attributable to claims is included in revenues when realization is probable and the amount can be reliably estimated.

The asset, "Costs and estimated earnings in excess of billings on uncompleted contracts," represents revenues recognized in excess of amounts billed. The liability, "Billings in excess of

* There are various other alternatives to the percentage-of-labor-hours method for measuring percentage of completion, which, in many cases, may be more appropriate in measuring the extent of progress toward completion of the contract (labor dollars, units of output, and the cost-to-cost method and its variations).

costs and estimated earnings on uncompleted contracts," represents billings in excess of revenues recognized.

Property and equipment. Depreciation and amortization are provided principally on the straight-line method over the estimated useful lives of the assets. Amortization of leased equipment under capital leases is included in depreciation and amortization.

Long-lived assets. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the excess of the asset's carrying amount and fair value of the asset and long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

Income taxes. Provisions for income taxes are based on taxes payable or refundable for the current year and deferred taxes on temporary differences between the amount of taxable income and pretax financial income and between the tax bases of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are included in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled as prescribed in Statement of Financial Accounting Standards (SFAS) No. 109, *Accounting for Income Taxes.* As changes in tax laws or rate are enacted, deferred tax assets and liabilities are adjusted through the provision for income taxes.

Construction contracts are reported for tax purposes on the completed-contract method and for financial statement purposes on the percentage-of-completion method. Accelerated depreciation is used for tax reporting, and straight-line depreciation is used for financial statement reporting.

Investment tax credits are applied as a reduction to the current provision for federal income taxes using the flow-through method.

Note 2: Fair Value of Financial Instruments*

The carrying amounts of the company's cash and cash equivalents, note receivable, and lease obligations payable approximate their fair value. The fair value of the company's notes payable is estimated at $490,500 based on the future cash flows associated with each note discounted using the company's current borrowing rate for similar debt.

Note 3: Contract Receivables

	December 31, 19X8	*December 31, 19X7*
Contract receivables		
Billed		
Completed contracts	$ 621,100	$ 500,600
Contracts in progress	2,146,100	1,931,500
Retained	976,300	866,200
Unbilled	121,600	105,400
	3,865,100	3,403,700
Less allowances for doubtful collections	75,900	69,600
	$3,789,200	$3,334,100

* SFAS No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities,* amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments,* to make the disclosures about fair value of financial instruments prescribed in SFAS No. 107 optional for entities that meet all of the following criteria:

a. The entity is a nonpublic entity.

b. The entity's total assets are less than $100 million on the date of the financial statements.

c. The entity has not held or issued any derivative financial instruments, as defined in SFAS No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments,* other than loan commitments, during the reporting period. (***Note:*** If SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* has been adopted, item "c" should be replaced with the following: "The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* during the reporting period.")

The total recorded investment in impaired contract receivables recognized in accordance with SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, was $125,000 in 19X8 and $103,000 in 19X7. These amounts also approximate the average recorded investment in impaired contract receivables during the related periods. The allowance for credit losses associated with these receivables was $41,000 in 19X8 and $38,000 in 19X7. It is management's policy not to accrue interest income on impaired contract receivables given past difficulties in collecting such amounts. Interest income on impaired contract receivables of $1,452 and $1,107 was recognized for cash payments received in 19X8 and 19X7, respectively. For impairment recognized in conformity with SFAS No. 114, as amended, the entire change in present value of expected cash flows is reported as bad debt expense in the same manner in which impairment initially was recognized or as a reduction in the amount of bad debt expense that otherwise would be reported.

Analysis of the changes in the allowance for doubtful collections:

	19X8	*19X7*
Balance at January 1	$69,600	$68,000
Additions charged to operations	6,300	1,100
Direct write-downs	—	500
Recoveries	—	—
Balance at December 31	$75,900	$69,600

Contract receivables at December 31, 19X8, include a claim, expected to be collected within one year, for $290,600 arising from a dispute with the owner over design and specification changes in a building currently under construction. The changes were made at the request of the owner to improve the thermal characteristics of the building and, in the opinion of counsel, gave rise to a valid claim against the owner.

The retained and unbilled contract receivables at December 31, 19X8 included $38,600 that was not expected to be collected within one year.

Contract receivables include approximately $800,000 due under one contract.*

Note 4: Costs and Estimated Earnings on Uncompleted Contracts

	December 31, 19X8	*December 31, 19X7*
Costs incurred on uncompleted contracts	$15,771,500	$12,165,400
Estimated earnings	1,685,900	1,246,800
	17,457,400	13,412,200
Less billings to date	17,619,200	13,533,300
	$ (161,800)	$ (121,100)
Included in accompanying balance sheets under the following captions:		
Costs and estimated earnings in excess of billings on uncompleted contracts	$ 80,200	$ 100,600
Billings in excess of costs and estimated earnings on uncompleted contracts	(242,000)	(221,700)
	$ (161,800)	$ (121,100)

* SFAS No. 105, *Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk and Financial Statements with Concentrations of Credit Risk*, requires disclosure of concentrations of credit risks of all financial instruments. Concentrations can be geographical areas, types of contracts, owners or others. Additionally, the contractor should disclose, for each significant concentration, the policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the contractor's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments. (***Note:*** SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, which is effective for all fiscal quarters of fiscal years beginning after June 15, 1999, supersedes SFAS 105. If SFAS 133 has been adopted, please refer to the "Checklists and Illustrative Financial Statements for Corporations" [FSP section 6000], for the relevant disclosure requirements.)

Note 5: Advances to and Equity in Unconsolidated Joint Venture

The Company has a minority (one-third) interest in a general partnership joint venture formed to construct an office building. All of the partners participate in construction, which is under the general management of the Company. Summary information on the joint venture follows:

	December 31, 19X8	*December 31, 19X7*
Current assets	$ 483,100	$280,300
Construction and other assets	220,500	190,800
	703,600	471,100
Less: Liabilities	236,800	154,000
Net assets	$ 466,800	$317,100
Revenue	$3,442,700	$299,400
Net income	$ 149,700	$ 17,100
Company's interest		
Share of net income	$ 49,900	$ 5,700
Advances to joint venture	$ 50,000	$ 25,000
Equity in net assets	155,600	105,700
Total advances and equity	$ 205,600	$130,700

(For the purposes of illustrative financial statements, the one-line equity method of presentation is used in both the balance sheet and the income statement. However, the pro rata consolidation method is acceptable if the investment is deemed to represent an undivided interest.)

Note 6: Transactions With Related Party

The note receivable, related company, is an installment note bearing annual interest at 9¼%, payable quarterly, with the principal payable in annual installments of $25,000, commencing October 1, 19Y0.

The major Company stockholder owns the majority of the outstanding common stock of this related company, whose principal activity is leasing land and buildings. The Company rents land and office facilities from the related company under a ten-year lease ending September 30, 19Y6, at an annual rental of $19,000.

Note 7: Property and Equipment

	December 31, 19X8	*December 31, 19X7*
Assets		
Land	$ 57,500	$ 57,500
Buildings	262,500	262,500
Shop and construction equipment	827,600	727,600
Automobile and trucks	104,400	89,100
Leased equipment under capital leases	300,000	300,000
	1,552,000	1,436,700
Accumulated depreciation and amortization		
Buildings	140,000	130,000
Shop and construction equipment	265,600	195,500
Automobiles and trucks	70,000	42,000
Leased equipment under capital leases	100,000	50,000
	575,600	417,500
Net property and equipment	$ 976,400	$1,019,200

SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* requires certain disclosures if an impairment loss is recognized for assets to be held and used. An example of such a disclosure is shown below:

Recently adopted environmental legislation has placed significant restrictions on the use of certain heavy equipment owned and operated by the company. This circumstance has called into question the recoverability of the carrying amounts of these assets. As a result, pursuant to SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* an impairment loss of $X,XXX has been recognized for this equipment and included as a component of income before income taxes under the caption "Selling, general and administrative expenses." In calculating the impairment loss fair value was determined by reviewing quoted market prices for current sales of similar equipment.

Note 8: Accounts Payable

Accounts payable include amounts due to subcontractors, totaling $634,900 at December 31, 19X8, and $560,400 at December 31, 19X7, which have been retained pending completion and customer acceptance of jobs. Accounts payable at December 31, 19X8 include $6,500 that is not expected to be paid within one year.

Note 9: Notes Payable*

	December 31, 19X8	*December 31, 19X7*
Unsecured note payable to bank, due in quarterly installments of $22,575 plus interest at 1% over prime	$388,100	$478,400
Note payable to bank, collateralized by equipment, due in monthly installments of $1,667 plus interest at 10% through December 19Y2	80,000	100,000
	$468,100	$578,400

Principal payments on notes payable are due as follows:

Year ending December 31	
19X9	$110,300
19Y1	$110,300
19Y2	$110,300
19Y3	$110,300
19Y4	$ 26,900

Note 10: Lease Obligations Payable

The company leases certain specialized construction equipment under leases classified as capital leases. The following is a schedule showing the future minimum lease payments under capital leases by years and the present value of the minimum lease payments as of December 31, 19X8:

Year ending December 31	
19X9	$ 76,500
19Y0	76,500
19Y1	76,500
Total minimum lease payments	229,500
Less amount representing interest	31,900
Present value of minimum lease payments	$197,600

* SFAS No. 47, *Disclosure of Long-Term Obligations,* also requires disclosure of maturities of long-term obligations for each of the five years following the balance-sheet date.

At December 31, 19X8, the present value of minimum lease payments due within one year is $92,250. Total rental expense, excluding payments on capital leases, totaled $86,300 in 19X8 and $74,400 in 19X7.

Note 11: Contingent Liability

A claim for $180,000 has been filed against the company and its bonding company arising out of the failure of a subcontractor of the company to pay its suppliers. In the opinion of counsel and management, the outcome of this claim will not have a material effect on the company's financial position, results of operations, or cash flows.

Note 12: Management Contracts

The company manages or supervises commercial and industrial building contracts of others for a fee. These fees totaled $121,600 in 19X8 and $1,700 in 19X7 and are included in contract revenues earned.

Note 13: Income Taxes and Deferred Income Taxes*

The provision for taxes on income consists of the following:

	December 31, 19X8	*December 31, 19X7*
Current	$451,700	$300,900
Deferred	211,200	(75,900)
Total	$662,900	$225,000

The following represents the approximate tax effect of each significant type of temporary difference giving rise to the deferred income tax liability:

	December 31, 19X8	*December 31, 19X7*
Deferred tax asset:		
Employee benefits	$ 44,300	$ 38,100
Other	10,100	10,600
Total	$ 54,400	$ 48,700
Deferred tax liability:		
Employee benefits	$594,000	$389,800
Property, plant, and equipment	64,300	54,100
Other	15,300	12,800
Total	$673,600	$456,700
Deferred tax liability, net	$619,200	$408,000

Note 14: Backlog**

The following schedule shows a reconciliation of backlog representing signed contracts, excluding fees from management contracts, in existence at December 31, 19X7 and 19X8:

* In addition to the information presented, SFAS No. 109, requires that a public enterprise disclose a reconciliation using percentages or dollar amounts of (*a*) the reported amount of income tax expense attributable to continuing operations for the year to (*b*) the amount of income tax expense that would result from applying domestic federal statutory tax rates to pretax income from continuing operations. The "statutory" tax rates shall be the regular tax rates if there are alternative tax systems. The estimated amount and the nature of each significant reconciling item shall be disclosed. A nonpublic enterprise shall disclose the nature of significant reconciling items but may omit a numerical reconciliation.

** The presentation of backlog information, although encouraged, is not a required disclosure.

Balance, December 31, 19X7	$24,142,600
Contract adjustments	1,067,100
New contracts, 19X8	3,690,600
	28,900,300
Less contract revenue earned, 19X8	22,432,500
Balance, December 31, 19X8	$ 6,467,800

In addition, between January 1, 19X9 and February 18, 19X9, the company entered into additional construction contracts with revenues of $5,332,800.

Note 15: Vulnerability Due to Certain Concentrations

In response to competitive pressures, and in line with current industry trends, the company has embarked upon an aggressive cost-cutting program.

Efforts to incorporate cost reductions in the collective bargaining agreements due to expire in the coming year are expected to meet with resistance from several labor guilds (approximately 75 percent of the company's labor force is covered by collective bargaining agreements, while approximately 40 percent of the company's labor force is covered by collective bargaining agreements that will expire within one year). Given these circumstances, and the company's past experience with work stoppages, management believes that it is reasonably possible that a protracted strike may take place thus resulting in a severe impact in the near term.

.08

Independent Auditor's Report on Accompanying Information

To the Shareholders and Board of Directors
Percentage Contractors, Inc.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying information, contained in the following schedules 1 through 3, is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature*]

[*City, State*]*

February 18, 19X9

* Optional if office location is on auditor's letterhead.

.09

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Schedule 1

Earnings from Contracts

Years Ended December 31, 19X8 and 19X7

	19X8			*19X7*
	Revenues earned	*Cost of revenues earned*	*Gross profit (loss)*	*Gross profit (loss)*
Contracts completed during the year	$ 6,290,800	$ 5,334,000	$ 956,800	$ 415,300
Contracts in progress at year end	16,141,700	14,636,900	1,504,800	921,400
Management contract fees earned	121,600	51,800	69,800	1,700
Unallocated indirect and warranty costs		46,700	(46,700)	(38,100)
Minority interest in joint venture		128,000	(128,000)	(26,200)
Charges on prior year contracts		162,000	(162,000)	
	$22,554,100	$20,359,400	$2,194,700	$1,274,100

.10

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Schedule 2

Contracts Completed

Year Ended December 31, 19X8

Contract		*Contract totals*			*Before January 1, 19X8*			*During the year ended December 31, 19X8*		
Number	*Type*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*
1511	B	$ 5,475,300	$ 4,802,500	$ 672,800	$3,223,400	$2,932,700	$290,700	$2,251,900	$1,869,800	$382,100
1605	A	695,000	880,900	(185,900)	596,100	558,100	38,000	98,900	322,800	(223,900)
1624	A	140,700	150,700	(10,000)	29,600	31,800	(2,200)	111,100	118,900	(7,800)
1711	A	2,725,100	2,391,700	333,400	1,654,100	1,510,000	144,100	1,071,000	881,700	189,300
1791	B	4,770,100	4,288,900	481,200	3,028,500	2,929,600	98,900	1,741,600	1,359,300	382,300
1792	A	635,000	457,900	177,100				635,000	457,900	177,100
Small contracts		413,400	349,500	63,900	32,100	25,900	6,200	381,300	323,600	57,700
		$14,854,600	$13,322,100	$1,532,500	$8,563,800	$7,988,100	$575,700	$6,290,800	$5,334,000	$956,800

Contract types
A—Fixed-price
B—Cost-plus-fee

PERCENTAGE CONTRACTORS, INC. AND SUBSIDIARIES

Schedule 3

Contracts in Progress

December 31, 19X8

Contract		*Total contract*		*From inception to December 31, 19X8*							*At December 31, 19X8*		*For the year ended December 31, 19X8*		
Number	*Type*	*Revenues*	*Estimated gross profit (loss)*	*Revenues earned*	*Total costs incurred*	*Cost of revenues*	*Gross profit (loss)*	*Billed to date*	*Estimated cost to complete*	*Costs and estimated earnings in excess of billings*	*Billings in excess of costs and estimated earnings*	*Revenues earned*	*Cost of revenues*	*Gross profit (loss)*
1845	A	$ 6,750,200	$ 877,000	$ 5,890,500	$ 5,244,500	$ 5,143,900	$ 746,600	$ 5,976,000	$ 628,700	$15,100		$ 5,664,200	$ 4,984,500	$ 679,700
1847	B	1,471,800	127,100	(1,250,400)	1,139,800	1,139,800	110,600	1,195,800	204,900	54,600		962,800	899,000	63,800
1912	A	451,800	(130,100)	108,600	238,700	238,700	(130,100)	98,100	343,200	10,500		98,600	191,500	(92,900)
1937	B	11,125,000	847,900	7,337,900	7,045,500	6,721,100	616,800	7,808,000	3,231,600		$145,700	6,981,900	6,469,900	512,000
1945	A	3,650,100	497,000	2,395,200	2,061,300	2,061,300	333,900	2,491,500	1,091,800		96,300	2,395,200	2,061,300	333,900
Small contracts		51,300	8,400	49,800	41,700	41,700	8,100	49,800	1,200			39,000	30,700	8,300
		$23,500,200	$2,227,300	$17,032,400	$15,771,500	$15,346,500	$1,685,900	$17,619,200	$5,501,400	$80,200	$242,000	$16,141,700	$14,636,900	$1,504,800

Contract types
A—Fixed-price
B—Cost-plus-fee

.12

Independent Auditor's Report

The Stockholders and Board of Directors
Completed Contractors, Inc.

We have audited the accompanying balance sheets of Completed Contractors, Inc. as of December 31, 19X8 and 19X7, and the related statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Completed Contractors, Inc. as of December 31, 19X8 and 19X7, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*City, State*]*

February 18, 19X9

* Optional if office location is on auditor's letterhead.

.13

COMPLETED CONTRACTORS, INC.

Balance Sheets

December 31, 19X8 and 19X7

	19X8	*19X7*
Assets		
Current assets:		
Cash	$ 242,700	$ 185,300
Contract receivables (less allowance for doubtful accounts of $10,000 and $8,000) (Note 3)	893,900	723,600
Cost in excess of billings on uncompleted contracts (Note 4)	418,700	437,100
Inventories at lower of cost or realizable value on first-in, first-out basis (Note 5)	463,600	491,300
Prepaid expenses	89,900	53,900
Total current assets	2,108,800	1,891,200
Cash value of life insurance	35,800	32,900
Property and equipment, at cost		
Building	110,000	110,000
Equipment	178,000	163,000
Trucks and autos	220,000	200,000
	508,000	473,000
Less accumulated depreciation	218,000	203,200
	290,000	269,800
Land	21,500	21,500
	311,500	291,300
	$2,456,100	$2,215,400
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities, long-term debt (Note 6)	$ 37,000	$ 30,600
Accounts payable	904,900	821,200
Accrued salaries and wages	138,300	155,100
Accrued and other liabilities	169,400	91,750
Billings in excess of costs on uncompleted contracts (Note 4)	34,500	43,700
Total current liabilities	1,284,100	1,142,350
Long-term debt, less current maturities (Note 6)	245,000	241,000
	1,529,100	1,383,350
Stockholder's equity:		
Common stock—$10 par value, 50,000 authorized shares, 23,500 issued and outstanding shares	235,000	235,000
Additional paid-in capital	65,000	65,000
Retained earnings	627,000	532,050
Total stockholders' equity	927,000	832,050
	$2,456,100	$2,215,400

The accompanying notes are an integral part of these financial statements.

.14

COMPLETED CONTRACTORS, INC.

Statements of Income[*] and Retained Earnings

Years Ended December 31, 19X8 and 19X7

	19X8	*19X7*
Contract revenues	$9,487,000	$8,123,400
Costs and expenses		
Cost of contracts completed	8,458,500	7,392,300
General and administrative expenses	848,300	643,100
Interest expense	26,500	23,000
	9,333,300	8,058,400
Net income	153,700	65,000
Basic and diluted earnings per share[**]	6.54	2.77
Retained earnings		
Balance, beginning of year	532,050	525,800
Dividends paid ($2.50 per share)	(58,750)	(58,750)
Balance, end of year	$ 627,000	$ 532,050

The accompanying notes are an integral part of these financial statements.

[*] SFAS 130, *Reporting Comprehensive Income,* establishes standards for the reporting and display of comprehensive income and its components. The Statement requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Statement does not require a specific format for that financial statement but requires that an enterprise display an amount representing total comprehensive income for the period in that financial statement. The Statement does not apply to an enterprise that has no items of other comprehensive income in any period presented.

[**] SFAS 128, *Earnings Per Share,* requires presentation of earnings per share by all entities that have issued common stock or potential common stock if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. The Statement also requires presentation of earnings per share by an entity that has made a filing or is in the process of filing with a regulatory agency in preparation for the sale of those securities in a public market.

.15

COMPLETED CONTRACTORS, INC.

Statements of Cash Flows*

Years Ended December 31,19X8 and 19X7

	19X8	*19X7*
Cash flows from operating activities:		
Net income	$153,700	$ 65,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	54,800	50,300
Provisions for losses on accounts receivable	2,000	1,000
Increase in contract receivables	(172,300)	(37,500)
Decrease (increase) in costs in excess of billings on uncompleted contracts	18,400	(49,100)
Decrease (increase) in inventories	27,700	(3,400)
Decrease (increase) in prepaid expenses	(36,000)	16,500
Increase in cash value of life insurance	(2,900)	(2,685)
Increase in accounts payable	83,700	24,600
Increase (decrease) in accrued salaries and wages	(16,800)	24,300
Increase (decrease) in accrued and other liabilities	77,650	(39,400)
Decrease in billings in excess of costs on uncompleted contracts	(9,200)	(16,300)
Net cash provided by operating activities	180,750	33,315
Cash flows from investing activities:		
Purchase of property and equipment	(75,000)	(53,500)
Net cash used in investing activities	(75,000)	(53,500)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt	44,000	68,000
Principal payments on long-term debt	(33,600)	(15,500)
Cash dividends paid	(58,750)	(58,750)
Net cash used in financing activities	(48,350)	(6,250)
Net increase (decrease) in cash	57,400	(26,435)
Cash, beginning of year	185,300	211,735
Cash, end of year	$242,700	$185,300
Supplementary data:		
Interest paid	$ 28,000	$ 25,000
Income taxes paid	$147,200	$ 52,000

The accompanying notes are an integral part of these financial statements.

* The indirect method is illustrated.

.16

COMPLETED CONTRACTORS, INC.

Notes to Financial Statements

Years Ended December 31, 19X8 and 19X7

Note 1: Nature of Operations and Significant Accounting Policies

Nature of operations. The company is a heating and air-conditioning contractor for residential and commercial properties serving the eastern region of New Hampshire. Work on new structures is performed primarily under fixed-price contracts. Work on existing structures is performed under fixed-price or time-and-material contracts.

Use of estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue and cost recognition. Revenues from fixed-price construction contracts are recognized on the completed-contract method. This method is used because the typical contract is completed in two months or less and financial position and results of operations do not vary significantly from those which would result from use of the percentage-of-completion method. A contract is considered complete when all costs except insignificant items have been incurred and the installation is operating according to specifications or has been accepted by the customer.

Revenues from time-and-material contracts are recognized currently as the work is performed.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs, and depreciation costs. General and administrative costs are charged to expense as incurred. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Claims are included in revenues when received.

Costs in excess of amounts billed are classified as current assets under costs in excess of billings on uncompleted contracts. Billings in excess of costs are classified under current liabilities as billings in excess of costs on uncompleted contracts. Contract retentions are included in accounts receivable.

Contract receivables. Contract receivables consist primarily of large groups of smaller-balance homogeneous accounts that are collectively evaluated for impairment, accordingly, the provisions of SFAS No. 114, *Accounting by Creditors for Impairment of a Loan*, do not apply.

Inventories. Inventories are stated at cost on the first-in, first-out basis using unit cost for furnace and air-conditioning components and average cost for parts and supplies. The carrying value of furnace and air-conditioning component units is reduced to realizable value when such values are less than cost.

Property and equipment. Depreciation is provided over the estimated lives of the assets principally on the declining-balance method, except on the building, where the straight-line method is used.

Long-lived assets. Long-lived assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the excess of the asset's carrying amount and fair value of the asset and long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

Income taxes. The company has elected subchapter S status for income tax purposes. Accordingly, a provision for income taxes has not been established.

Note 2: Fair Value of Financial Instruments*

The carrying amounts of the company's cash and cash equivalents, and current maturities of long-term debt approximate their fair value. The fair value of the company's long-term debt is estimated at $300,500 based on the future cash flows associated with each note discounted using the company's current borrowing rate for similar debt.

Note 3: Contract Receivables

	December 31, 19X8	*December 31, 19X7*
Completed contracts, including retentions	$483,300	$408,600
Contracts in progress		
Current accounts	386,900	276,400
Retentions	78,700	46,600
	903,900	731,600
Less allowance for doubtful accounts	10,000	8,000
	$893,900	$723,600

Retentions include $10,300 in 19X8, which is expected to be collected after one year.

Note 4: Costs and Billings on Uncompleted Contracts

	December 31, 19X8	*December 31, 19X7*
Costs incurred on uncompleted contracts	$2,140,400	$1,966,900
Billings on uncompleted contracts	1,756,200	1,573,500
	$ 384,200	$ 393,400
Included in accompanying balance sheets under the following captions:		
Costs in excess of billings on uncompleted contracts	$ 418,700	$ 437,100
Billings in excess of costs on uncompleted contracts	(34,500)	(43,700)
	$ 384,200	$ 393,400

Contract receivables include approximately $200,000 due under one contract.**

* SFAS No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities,* amends SFAS No. 107, *Disclosures about Fair Value of Financial Instruments,* to make the disclosures about fair value of financial instruments prescribed in SFAS No. 107 optional for entities that meet all of the following criteria:

a. The entity is a nonpublic entity.

b. The entity's total assets are less than $100 million on the date of the financial statements.

c. The entity has not held or issued any derivative financial instruments, as defined in SFAS No. 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments,* other than loan commitments, during the reporting period. (*Note:* If SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* has been adopted, item "c" should be replaced with the following: "The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* during the reporting period.")

** SFAS No. 105 requires disclosure of concentrations of credit risks of all financial instruments. Concentrations can be geographical areas, types of contracts, owners or others. Additionally, the contractor should disclose, for each significant concentration, the policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the contractor's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments. (*Note:* SFAS 133, *Accounting for Derivative Instruments and Hedging Activities,* which is effective for all fiscal quarters of fiscal years beginning after June 15, 1999, supersedes SFAS 105. If SFAS 133 has been adopted, please refer to the "Checklists and Illustrative Financial Statements for Corporations" [FSP section 6000], for the relevant disclosure requirements.)

Note 5: Inventories

	December 31, 19X8	*December 31, 19X7*
Furnace and air-conditioning components	$303,200	$308,700
Parts and supplies	160,400	182,600
	$463,600	$491,300

Furnace and air-conditioning components include used items of $78,400 in 19X8 and $71,900 in 19X7 that are carried at the lower of cost or realizable value.

Note 6: Long-Term Debt

	December 31, 19X8	*December 31, 19X8*
Notes payable, bank		
Notes due in quarterly installments of $2,500, plus interest at 8%	$140,000	$150,000
Notes due in monthly installments of $1,500, plus interest at prime plus 1½%	87,000	58,000
Mortgage payable		
Due in quarterly payments of $3,500, including interest at 9%	55,000	63,600
	282,000	271,600
Less current maturities	37,000	30,600
	$245,000	$241,000

Principal payments on long-term debt are due as follows:

19X9	$ 37,000
19Y0	37,000
19Y1	37,000
19Y2	37,000
19Y3	34,000
Thereafter through 19Y5	100,000
	$282,000

Note 7: Backlog*

The estimated gross revenue of work to be performed on signed contracts was $4,691,000 at December 31, 19X8, and $3,617,400 at December 31, 19X7. In addition to the backlog of work to be performed, there was gross revenue, to be reported in future periods under the completed-contract method used by the company, of $2,460,000 at December 31, 19X8, and $2,170,000 at December 31, 19X7.

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* The presentation of backlog information, although encouraged, is not a required disclosure.

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